

Market Observations December 2017

TAXING

Material changes to the U.S. income tax system appear at hand. Details await finalization, and the “devil” certainly will be in them. Debate over these changes has included sharply differing views on appropriate rates, income levels to be taxed and the impact on overall economic activity. For individuals, what should be the relative tax burden among income groups? For corporations, what tax structure and rates will help them compete with their foreign counterparts? A historical review can provide perspective.

Perspective

Changes to the U.S. income tax system have been more the rule over time. **Chart I** shows the trend in U.S. individual income tax rates over the past 70 years. Minimum and maximum rates are from Internal Revenue Service (“IRS”) tables. Effective rates were calculated from economy-wide data published by the U.S. Department of Commerce Bureau of Economic Analysis (“BEA”). Shown here is the ratio of total personal taxes to total personal income. The effective rate has remained so low over time due the reduction of personal income to taxable income from a vast number of adjustments, exemptions, deductions and credits.

Trends in corporate income tax rates are shown in **Chart II**. IRS tables and BEA data were used. The effective corporate rate shown here is the ratio of total taxes on corporate income to total corporate profits. While there have been few changes in IRS tables over the past thirty years, a steady decline in the effective corporate tax rate is clear. The average quarterly effective rate was 21.3% since the Great Recession and reached 20.4% for 3Q2017. An array of deductions and credits stands between corporate revenue and taxes.

Gauging the impact of any changes to a tax system is extremely difficult given the many parameters at work including behavioral responses of either individuals or corporations to these changes. **Chart III** compares long-term annualized growth rates for key measures. Two stand out: corporate income taxes have grown somewhat less than other measures and stock returns have been quite a bit higher.

Investment Implications

Changes in the U.S. tax system likely will affect both individual and corporate behaviors but in ways that are difficult to predict. Perhaps more important are levels of certainty with respect to both the timing and the permanency of any changes. With more certainty, more confidence can be given to decisions. Such confidence extends to portfolio actions. Investors seek to maximize after-tax returns. They weigh tax considerations both in determining what to buy and sell, and when to do so. Minimizing the tax burden is just one part of prudent portfolio management.

Taxing . . . 2. a) requiring (a person) to pay a percentage of his income for the support of the government . . . 4. imposing a burden on . . .

Webster's New World Dictionary, 1962

Chart I

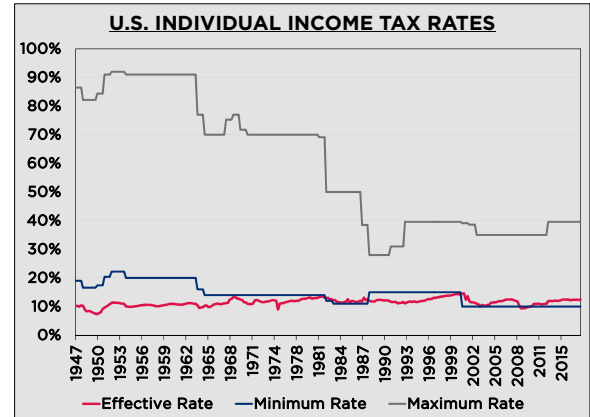


Chart II

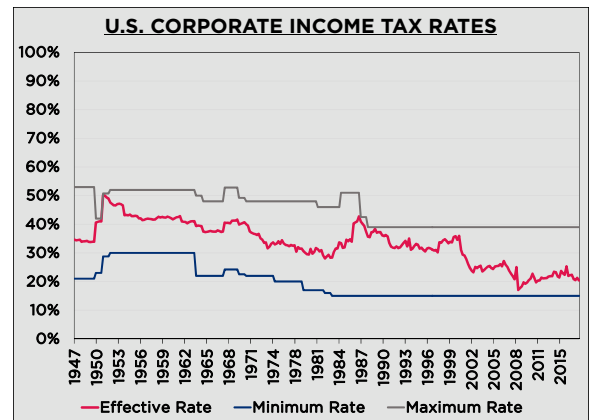


Chart III

